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88-106

No.

Supreme Court, U.S.
FILED
JUL 18 1988
JOSEPH F. SPANIOL, JR.
CLERK

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1988

—o—

OSCAR S. WYATT, JR.,

Petitioner,

v.

GEORGE P. JOUFLAS,
and
PHOENIX PETROLEUM COMPANY,

Respondents.

—o—

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

—o—

PETITION FOR WRIT OF CERTIORARI

—o—

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July 18, 1988

QUESTIONS PRESENTED FOR REVIEW

1. Whether there was clear error in the District Court's failure to address, even in summary form, the Petitioner's defense especially since the Court's findings were the verbatim adoption of an opposing party's proposed findings of fact, conclusions of law and order?

2. Whether the Petitioner was denied due process of law when the Court granted a money judgment against him on a promissory note even though the issue of Petitioner's liability on that note was not raised in the pleadings nor presented in the evidence?

THE PARTIES

The Petitioner (Co-Defendant in the United States District Court), Oscar S. Wyatt, Jr., is an individual and citizen of the State of Texas. The Respondent (Plaintiff in the United States District Court) is George P. Jouflas, is an individual and a citizen of the State of Colorado. The Respondent (Co-Defendant in the United States District Court) Phoenix Petroleum Company, is a Texas corporation. The other Defendant in the United States District Court is Hubert Peterson, Public Trustee of Eagle County, Colorado. Hubert Peterson has no interest in the outcome of the petition and pursuant to SUP. CT. R. 19.6 is not a party to this action.

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OPINIONS BELOW

The opinion of the District Court of Colorado is unreported (Appendix B). The opinion of the Court of Appeals for the Tenth Circuit is unreported (Appendix C) and was amended (Appendix D).

JURISDICTION

The opinion of the Court of Appeals was dated March 4, 1988. That Court denied Petitioner's Petition for Rehearing on April 18, 1988. This Court has jurisdiction to review the judgment by Writ of Certiorari pursuant to 28 U.S.C. § 1254(1) (1948).

STATUTE INVOLVED

This matter involves FED. R. CIV. P. 52 which states in pertinent part:

> "In all actions tried upon facts without a jury . . . the court shall find the facts specifically and state separately its conclusions thereon . . ."

STATEMENT OF THE CASE

This case was filed by George Jouflas ("Jouflas") in the Eagle County District Court on December 15, 1982 against Oscar Wyatt ("Wyatt"), Phoenix Petroleum Company ("Phoenix") and Hubert Peterson, the Public Trustee of Eagle County, Colorado. Hubert Peterson was a nominal party. In February, 1983, the case was removed to the United States District Court for the District of Colorado on the basis of diversity of citizenship under 28 U.S.C. § 1332 (1976).

This lawsuit resulted from a complicated transaction between Wyatt and Jouflas. In 1977, Jouflas, a licensed real estate broker, owned approximately 4,057 acres of ranch property in Eagle County, Colorado ("the property"). He wanted to subdivide and sell the property in such a way as to preserve his right to report income as a capital gain. To obtain this result, he put together a program to market the property and sought out Wyatt to interest him in the project.

Wyatt and Jouflas reached an agreement in which Jouflas would "sell" his land to Wyatt for $6,000,000.00 and Wyatt would execute a non-recourse promissory note secured by a deed of trust on the property. Such an arrangement would provide Jouflas with the substantial tax advantages he sought. Jouflas agreed to subordinate his $6,000,000 note to the bank which would provide the development funds. While the parties agreed that Wyatt would help Jouflas develop the property, they also agreed that Wyatt's participation would be without recourse or personal liability.

In accordance with the agreement, Wyatt borrowed $900,000.00 from the First National Bank of Denver ("Phoenix Note"). With this money, he paid Jouflas' existing debts on the property and began development. Because of Jouflas' subordination, the bank obligation was secured by the first deed of trust in favor of the First National Bank of Denver. Of the $900,000.00, $678,000.00 was immediately applied to clear the title of prior liens Jouflas had on the land. The remainder, along with an additional $500,000.00 of Wyatt's personal funds, went directly into the property for drilling water wells, building roads, and other development. Development continued until the Fall of 1978 when the project ran into unexpected trouble and work was discontinued. At that point Wyatt had invested $1.4 million in the project.

In 1978, Wyatt and the bank agreed to defer the payments on the $900,000.00 bank note and not immediately reduce the principal if Wyatt provided additional collateral. Two certificates of deposit in the amount of $225,000.00 were accepted by the bank as additional collateral. From 1978 through 1981 while Wyatt paid the interest due on the full $900,000.00, he never made any payments intended to reduce the principal.

In November, 1981 the bank assigned its interest in the note and first deed of trust to Phoenix. Phoenix purchased the note for $928,553.42, the full principal amount plus outstanding interest. After its assignment of the note to Phoenix, the bank returned the certificates of deposit to Wyatt. By at least January 1982 Jouflas was aware of the assignment of the note from the bank to Phoenix.

In October 1979 Jouflas began foreclosure proceedings on the property in State District Court, Eagle County, Colorado, *Jouflas, v. Wyatt, et al.*, Civil Action No. 79-CV-240. In that action Jouflas also sued the First National Bank of Denver. That case was tried to the State District Court in March, 1982. Judgment was entered for Jouflas in August, 1982. A sheriff's sale followed on November 12, 1982. Jouflas being the high bidder received a certificate of purchase on November 15, 1982.

In November 1982 Phoenix began foreclosure proceedings on the land pursuant to its first deed of trust, the debt to which Jouflas had agreed to subordinate. Jouflas responded by commencing this present action in State District Court on December 2, 1982. That matter was removed to the United States District Court for the District of Colorado and is the underlying District Court action.

The case was tried to the court on October 9 and 10, 1984. On November 27, 1985, over a year later, the court entered its Judgment (Appendix A) and Memorandum, Findings of Fact, Conclusions of Law and Order (Appendix B) adopting verbatim the findings, proposed prior to trial, by Jouflas' counsel. Among other issues, the court found that Jouflas was entitled to be subrogated to the extent of $478,553.42 of the Phoenix claim against Wyatt. Nowhere in the findings did it address Wyatt's contention that there was an agreement which prohibited subrogation. On the same date it entered a personal money judgment of $478,553.42 plus interest against Wyatt based on Jouflas' subrogation to the Phoenix lien. Nowhere in the order, pleadings or evidence was the issue of Wyatt's liability on the Phoenix note addressed.

ARGUMENT

I.

HAD THE TENTH CIRCUIT CRITICALLY ANALYZED THE RECORD AS REQUIRED AFTER THE VERBATIM ADOPTION OF FINDINGS BY THE TRIAL COURT, IT WOULD HAVE FOUND THAT THE COURT FAILED TO MAKE FINDINGS ON EVERY MATERIAL ISSUE, INCLUDING WYATT'S DEFENSE TO THE DOCTRINE OF EQUITABLE SUBROGATION. SUCH A FAILURE WAS CLEARLY ERRONEOUS.

The law is clear even if the parties do not expressly agree there will be no subrogation, the doctrine is inappropriate if the contract either expressly or by implication forbids it, *Southern Cotton Oil Co. v. Napoleon Hill Cotton Co.*, 108 Ark. 555, 158 S.W. 1082 (1913), or if it is inconsistent with or in violation of one's legal rights. *Texas Co. v. Miller*, 165 F.2d 111 (5th Cir. 1947).

Wyatt contended that there was an agreement that he would have no personal liability to Jouflas, including through subrogation. The transaction was structured to aid Jouflas' tax planning and to limit Wyatt's financial exposure. As such, the agreement encompassed numerous documents, i.e., an agreement, the promissory note from Wyatt to the First National Bank, a promissory note from Wyatt to Jouflas, the deed from Jouflas to Wyatt, and the mortgage from Wyatt to Jouflas.

Besides these documents, there was other evidence supporting this limitation of liability. For instance, Jouflas acknowledged that Wyatt wanted to put no money

into the project. Wyatt testified that it was his intent to have no personal liability in the transaction and furthermore, although the Phoenix Note was structured as a note on which he was the maker, he was in reality guaranteeing the development loan needed by Jouflas. Additionally, on November 11, 1977, when Wyatt purchased the Jouflas property with a *non-recourse* note for approximately $6,000,000.00, Jouflas had full knowledge of the Phoenix Note which had been executed on September 14, 1977, and agreed to subordinate his own note to that obligation. Because of the November 11, 1977 documents, Jouflas' only remedy against Wyatt was to foreclose on the property. As such, Jouflas knew if he were the purchaser at a foreclosure sale he would hold the property subject to the Phoenix Note.

Based on the foregoing, the District Court was required to find whether there was an agreement that upon foreclosure of the Phoenix Note the doctrine of equitable subrogation, at least as against Wyatt, would not apply. FED. R. CIV. P. 52 required the court to make findings of controverted material issues in order to support its conclusion that subrogation was applicable to these parties. *Commissioner v. Duberstein*, 363 U.S. 278 (1960); *United States v. Causby*, 328 U.S. 256 (1946). No such findings were made. The failure of the District Court to make findings of fact on a material issue which was part of underlying facts upon which conclusory finding was based, is clearly erroneous. *Salinas v. Roadway Express, Inc.*, 735 F.2d 1574, (5th Cir. 1984); *E.E.O.C. v. United Virginia Bank/Seaboard Nat'l*, 555 F.2d 403 (4th Cir. 1977); *Rothenberg v. Security Management Co.*, 736 F.2d 1470 (11th Cir. 1984).

The problem is compounded by the manner in which the Court ruled. This case was tried to the District Court on October 9 and 10, 1984. Prior to trial, plaintiff Jouflas proposed Findings of Fact, Conclusions of Law and Judgment. After the trial the Court entered its Memorandum Findings of Fact, Conclusions of Law and Order. With the exception of the first paragraph (which is largely introductory in nature) the Court's Findings and Conclusions are verbatim the proposed Findings of Fact, Conclusions of Law and Judgment submitted by Jouflas. Comparison of the proposed and actual documents reveals that the only changes are very minor revisions in the wording of the text that do not affect the meaning or substance. In fact, the court's citation of several of the cases supporting its decision have spelling errors identical to those contained in the Plaintiff's proposed findings. For example, in the Court's findings, the case cited as *Briggs v. Obermeyr* should be *Biggs v. Obermeyer*, and the name of the defendant in *American Oil Co. v. McMillin* is properly spelled McMullin.

Rule 52 of the Federal Rules of Civil Procedure requires that "in all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusion of law thereon . . ." FED. R. CIV. P. 52(a). The 10th Circuit has stated in *Featherstone v. Barash*, 345 F.2d 246 (10th Cir. 1965) that the purpose of Rule 52 is to "aid the appellate court by affording it a clear understanding of the ground or basis of the decision of the trial court, to make definite what is decided in order to apply the doctrines of estoppel and res judicata to future cases, and to evoke care on the part of the trial judge in considering and adjudicat-

ing the facts in dispute. The sufficiency of findings must be measured by the requirements of the rule and in light of these purposes." *Featherstone*, 345 F.2d at 249.

Although the practice of allowing counsel to submit proposed findings is permitted, the verbatim adoption of proposed findings has been sharply criticized. This Court addressed this issue in *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964), a civil suit dealing with alleged violations of Section 7 of the Clayton Act. After trial, the District Court judge announced from the bench that judgment would be for the defendant and requested defendant's counsel to "prepare findings of fact, conclusions of law and judgment." *El Paso*, 376 U.S. at 656. In response, defendant's counsel submitted 130 findings of fact and one conclusion of law all of which the District Court adopted verbatim. This Court indicated that although this "mechanical adoption" of findings need not be rejected out of hand if supported by the evidence, this Court criticized the procedure for failing to reveal the discerning line for decision on the basic issue in the case. *El Paso*, 376 U.S. at 656-657.

When a court adopts Findings of Facts verbatim, the appellate court is required to critically analyze the record. *Ramey Constr. Co., Inc. v. Apache Tribe of Mescalero Reservation*, 616 F.2d 464, 467 (10th Cir. 1980). After the trial court's verbatim adoption of Jouflas' findings, prepared before trial, had the Court of Appeals applied the critical analysis of the record it would have had no choice but to find that the District Court failed to adequately address facts regarding the agreement and understanding of the parties. The existence of such an agreement forbids the application of the doctrine of

equitable subrogation against Wyatt. The Court should have noted that such failure to address issues before the court was improper and reversed and remanded for further findings.

ARGUMENT

II.

THE ISSUE OF WYATT'S PERSONAL LIABILITY ON A NOTE WAS NOT TRIED AND THEREFORE THE COURT DENIED HIM DUE PROCESS OF LAW WHEN IT ENTERED A JUDGMENT AGAINST HIM PERSONALLY BASED SOLELY ON JOUFLAS' RIGHT TO SUBROGATION UNDER THAT NOTE.

The trial court entered money judgment for Jouflas and against Wyatt in the amount of $478,553.42. This judgment was based solely on Jouflas' claim to be equitably subrogated to the Phoenix Note. In allowing the judgment the court stated:

> However, Jouflas is entitled to a judgment of this same amount against Wyatt. Whenever a party is compelled, though not personally bound, to pay a debt in order to protect his property from foreclosure, he is entitled to judgement against the original debtor in the amount of any funds so expended. *American Oil Co. v. McMillin* [sic], 508 F.2d 1345 (10th Cir. 1975); *Saunders v. Black*, 136 Colo. 417, 318 P.2d 1100 (1958); *Martynes & Associates, No. 1 v. Devonshire Square Apartments*, 680 P.2d 246 (Colo. Appl 1984[)]; *Cagle v. Sammons*, 198 Neb. 595, 254 N.W.2d 398 (1977).

None of the cases cited by the Court gave it the authority to enter a direct personal judgment against

Wyatt without first litigating the issue of Wyatt's liability on the underlying obligation.

Being subrogated into another's position does not give a direct right to a judgment against the debtor. Rather, a subrogee must pursue his claim for relief as in any other action. *See, Hartford Accident & Indem. Co. v. Colorado Nat'l. Bank of Denver*, 96 Colo. 127, 40 P.2d 254 (1934). *Cobbey v. Peterson*, 89 Colo. 350, 3 P.2d 298, 299 (1931). A subrogee "cannot acquire by subordination greater rights against the debtor than the subrogor possessed." *United States v. Winter*, 319 F. Supp. 520, 521 (E.D. La. 1970). The subrogee is subject to any defenses previously available against the subrogor, *State v. Smither*, 290 Or. 827, 626 P.2d 356 (1981); *United States v. Munsey Trust Co.*, 332 U.S. 234 (1947) and stands in the place of the one whose claim he has paid as if the payment which gave rise to the subrogation had not been paid. *Phoenix Ins. Co. of Brooklyn v. Erie & Western Transp. Co.*, 117 U.S. 312 (1886). *Jorski Mill & Elevator Co. v. Farmers Elevator Mut. Ins. Co.*, 404 F.2d 143, 147 (10th Cir. 1968). By entering judgment directly against Wyatt the court skipped the crucial step of giving Wyatt the opportunity to defend his liability on the Phoenix note.

The Supreme Court of Alabama has succinctly stated the rule of subrogation in *Crutchfield v. Johnson & Latimer*, 243 Ala. 73, 8 So. 2d 412, 414 (1942), as follows:

> A person entitled to subrogation must work through the creditor whose rights he claims. He stands in the shoes of the creditor and is entitled to the benefit of all the remedies of the creditor and may use all

> means which the creditor could to enforce payment. *American Trust & Savings Bank v. Turner*, 16 Ala. App. 602, 80 So. 176. But he can only enforce such rights as the creditor could enforce, and must exercise such rights under the same conditions and limitations as were binding on the creditor, and hence, can be subrogated to no greater rights than the one in whose place he is substituted. *Teague v. Corbitt*, 57 Ala. 529; 60 Corpus Juris pp. 723, 724, § 35.

The Court then continued its analysis by stating:

> A mortgagee paying a prior mortgage is *merely subrogated to the lien* of the prior mortgage, and, in order to recover the sum paid on foreclosure of his mortgage, he *must plead and prove facts* showing the right to foreclose the prior mortgage. [Emphasis added.]

Nowhere in the record or the pleadings was the issue of Wyatt's liability on the Phoenix Note or his defenses to that liability raised. In his fourth claim for relief, Jouflas sought to be subrogated into Phoenix's position. The prayer for the fourth claim sought a personal judgment against Wyatt. However, the claim as stated did not entitle him to such relief. "Since the prayer for relief forms no part of the cause of action, and the pleader will be entitled to the relief made out in the case and stated in the pleadings, irrespective of what is asked for in the prayer." *Schoonover v. Schoonover*, 172 F.2d 526, 530 (10th Cir. 1949).

Since the issue of Wyatt's liability was not framed by the pleadings nor incorporated in evidence at trial

and since neither Phoenix nor Jouflas, as a potential subrogee of Phoenix's claim, filed a cross-claim or claim against Wyatt on the note, the relief sought and obtained was not authorized under the claim asserted. A court may not enter judgment beyond the claim asserted, for to do so would violate that party's rights to due process. *Standard Oil Co. of Ind. v. Missouri*, 224 U.S. 270 (1912) *Reynolds v. Stockton*, 140 U.S. 254 (1891); *Jiminez v. Tuna Vessel "Granada,"* 652 F.2d 415 (5th Cir. 1981); *American Sur. Co. v. Baldwin*, 287 U.S. 156 (1932); *United States v. Seminole Nation*, 299 U.S. 417 (1937).

In *Standard Oil*, the Court stated at 244 U.S. 281-282,

> Though the court may possess jurisdiction of a cause, of the subject-matter, and of the parties, it is still limited in its modes of procedure, and in the extent and character of its judgments. It must act judicially in all things, and cannot then transcend the power conferred by the law. If, for instance, the action be upon a money demand, the court, notwithstanding its complete jurisdiction over the subject and parties, has no power to pass judgment of imprisonment in the penitentiary upon the defendant. If the action be for a libel or personal tort, the court cannot order in the case a specific performance of a contract. If the action be for the possession of real property, the court is powerless to admit in the case the probate of a will . . . The judgments mentioned, given in the cases supposed, would not be merely erroneous, they would be absolutely void, because the court, in rendering them, would transcend the limits of its authority in those cases.

The action was for Jouflas to be subrogated to the rights of Phoenix Petroleum. The Court had no authority to enter a judgment against Wyatt without determining Wyatt's liability on the Note. The judgment as entered was in violation of Wyatt's right to due process of law.

CONCLUSION

The issue of Wyatt's personal liability on the note was never raised by the pleadings, by the Pretrial Order, by the contentions of the parties or by the evidence at trial. The only issue raised was Jouflas' right to subrogation which, as seen in Wyatt's argument above, does not transfer or otherwise give Jouflas the right to an unadjudicated liability or judgment. By their proposed findings Jouflas and his counsel bypassed a critical step and gained a judgment against Wyatt on an issue not tried by the Court and failed to address a critical defense. By adopting verbatim these proposed findings and entering judgment against Wyatt, the Court has denied Wyatt due process of law based on a decision which was clearly erroneous. The entire course of proceedings in the trial court and the 10th Circuit's sanctioning of those proceedings, transcend mere errors in law and constitute a substantial departure from the accepted and usual course of judicial proceedings so as to call for an exercise of this Court's power of supervision. Review by a Writ of Certiorari is appropriate.

For the foregoing reasons, the petitioner respectfully requests that the Court grant the Petition for a Writ of Certiorari.

Respectfully submitted,

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APPENDIX A

JUDGMENT

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO,
Civil Action No. 83-C-177

GEORGE P. JOUFLAS,
Plaintiff,

vs.

HUBERT PETERSON,
Public Trustee of Eagle County, Colorado,
PHOENIX PETROLEUM COMPANY,
OSCAR S. WYATT, JR.
Defendants.

Pursuant to and in accordance with the Memorandum Findings of Fact, Conclusions of Law and Order entered by the Honorable Jim R. Carrigan, United States District Court Judge, on November 27, 1985, it is

ORDERED AND ADJUDGED that judgment is entered for the plaintiff, George P. Jouflas, and against the defendant, Oscar S. Wyatt, Jr. in the amount [of] $478,553.42 plus interest at the rate of 10 percent compounded annually from November 13, 1981 until the date of entry of this judgment upon which the interest is at the rate of 7.87 percent per annum. It is

FURTHER ORDERED that judgment be stayed until further order of this court, which will be granted

upon proof of plaintiff's payment to Phoenix Petroleum Company or the Public Trustee of Eagle County, Colorado of this sum. It is

FURTHER ORDERED that the plaintiff shall have his costs of action to be taxed upon the filing of a Bill of Costs within ten day [sic] after entry of this judgment.

DATED at Denver, Colorado, this 27 day of November, 1985.

BY THE COURT

JAMES R. MANSPEAKER, CLERK

BY: /s/
Stephen P. Ehrlich, Chief
Deputy Clerk

APPROVED BY:

/s/
Jim R. Carrigan, Judge

Entered on the Docket November 29, 1985.

APPENDIX B

MEMORANDUM FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO,
Civil Action No. 83-C-177

GEORGE P. JOUFLAS,
Plaintiff,

vs.

HUBERT PETERSON,
Public Trustee of Eagle County, Colorado,
PHOENIX PETROLEUM COMPANY,
OSCAR S. WYATT, JR.
Defendants.

CARRIGAN, J.

Plaintiff George P. Jouflas (hereinafter called Jouflas), a Colorado citizen, commenced this action in the Colorado District Court for Eagle County, Colorado. Defendant Phoenix Petroleum Company (Phoenix) is a Texas corporation with its principal place of business in Texas, and the defendant Oscar S. Wyatt, Jr. (Wyatt) is a Texas citizen. Defendant Hubert Peterson (Peterson) is a citizen of Colorado, but because he is only a nominal party with no real interest, his citizenship is disregarded for purposes of determining jurisdiction.

The case is here by removal and this court has diversity jurisdiction under 28 U.S.C. § 1332. This memorandum constitutes my findings of fact and conclusions of law as required by Rule 52(a), Fed. R. Civ. P. Unfortunately, time is not available to write an opinion fully explaining this case.

In 1977, Jouflas owned over 4,000 acres of land in Eagle County, Colorado, known as the Jouflas Ranch. In the summer of that year, Wyatt was negotiating with Jouflas to purchase the Jouflas Ranch. During the negotiations, Wyatt applied for a loan from the First National Bank of Denver (Bank), and, in August, the Bank committed to loan Wyatt $900,000, to be secured by the Jouflas Ranch. At the time of the loan commitment, the Bank knew that Jouflas would be financing Wyatt's purchase of the Jouflas Ranch and that his loan to Wyatt for the purchase price would be secured by a mortgage on the Jouflas Ranch. As a condition to making its loan commitment, therefore, the Bank required Jouflas to subordinate his security interest to the Bank's deed of trust.

In November 1977, Jouflas conveyed the Jouflas Ranch to Wyatt, who executed two notes. One was a non-recourse note for over $6,000,000 payable to Jouflas and secured by a mortgage on the Jouflas Ranch. The other was a $900,000 note ("Note") dated September 14, 1977, payable to the Bank and secured by a deed of trust on the Jouflas Ranch. (Since this litigation involves primarily the $900,000 note, it will be referred to as the Note, capitalized.) The Note provided for interest at 3/4% above the Bank's prime rate until maturity, and at 10%

after maturity. The Wyatt-to-Jouflas mortgage provided that it would be subordinate to a specific "promisory [sic] note in the amount of $900,000 for the use and benefit of the First National Bank of Denver."

Although the terms of the Bank's Note required payment in full on September 14, 1978, Wyatt made no payment at that time. Instead, in January 1979, without notifying Jouflas or obtaining his consent, Wyatt and the Bank modified the Note and deed of trust to provide for annual principal reduction payments of $225,000, beginning in September 1979, with the entire unpaid balance of the Note to be due in September 1982.

Wyatt also failed to meet the modified Note payment schedule. Instead, in September 1979, Wyatt sent $225,000 to the Bank to be placed in a non-interest-bearing certificate of deposit. The certificate was assigned by Wyatt to the Bank "to be applied to the unpaid principal balance" of the Note. The Bank handled a second $225,000 payment made by Wyatt the following September in the same manner. Although the terms of the Note permitted the Bank to apply any of Wyatt's funds in its possession toward the Note, the Bank chose not to do so.

When the September 1981 principal payment fell due, Wyatt began arranging to have Phoenix, whose president and sole stockholder was a long-time personal friend of Wyatt, purchase the Note for the interest due to the date of sale of the Note, ($28,553.42) plus the full principal amount of $900,000. With Phoenix's acquiescence, but with no notice to Jouflas, the Bank then released the two certificates of deposit to Wyatt. Phoenix, its president, and the Bank had full knowlege at the

time the Note was sold to Phoenix on November 13, 1981, that Jouflas held a junior priority mortgage on the Jouflas Ranch, that the Bank note was in default under both its original terms and its modified terms, and that the Bank would be returning the $450,000 security to Wyatt.

Wyatt defaulted on his Note to Jouflas, and Jouflas commenced state foreclosure proceedings in October 1979. Jouflas was the successful bidder at the sheriff's sale, bidding $6,407,744.40.

A sheriff's deed to the ranch was issued to Jouflas when Wyatt's redemption rights expired in May 1983.

In the meantime, in November 1982, Phoenix had commenced a foreclosure proceeding against the Jouflas Ranch to satisfy Wyatt's Note. Jouflas then brought this action in the district court for Eagle County, Colorado, and as stated, Wyatt removed the case to this court. Jouflas' action sought a preliminary injunction enjoining the sale of the Jouflas Ranch under the Bank's deed of trust. I entered that preliminary injunction in March 1983.

Jouflas claims that the two $225,000 payments by Wyatt to the Bank should have been used to reduce the balance owed on the promissory note. Alternatively, Jouflas asserts that the certificates of deposit purchased with this $450,000 became additional security for payment of the Note, and that the Bank's release of those certificates to Wyatt, to the extent of their $450,000 value, effected a release of the Jouflas Ranch from the deed of trust. Jouflas also claims that he is entitled to an injunction against Phoenix's foreclosure on the Jouf-

las Ranch, on the ground that Phoenix should be required to sue Wyatt personally under the Note before resorting to foreclosure against the land.

Alternatively, Jouflas contends that the deed of trust no longer has priority over the Jouflas mortgage bacause the Note and deed of trust have been modified to Jouflas' detriment without his consent, and because Wyatt, the Bank and Phoenix improperly attempted to injure Jouflas' security position. Thus, Jouflas argues, Phoenix is limited to enforcing such equitable redemption rights as the court sees fit to award it.

Finally, Jouflas requests that, if Phoenix is permitted to foreclose against the Jouflas Ranch for all or any part of the note, Jouflas should have judgment against Wyatt in the amount of any sums Jouflas is required to pay in order to save his ranch from the Phoenix foreclosure.

Phoenix requests judgment permitting its foreclosure against the Jouflas Ranch. Wyatt seeks declaration of the rights of the parties under the Note and deed of trust and also alleges that Jouflas breached an agreement to subordinate his mortgage to the Bank's deed of trust.

Each of the two $225,000 payments to the Bank was transferred by Wyatt to the Bank (in the fall of 1979 and fall of 1980) approximately when a principal payment fell due under the Note. Wyatt's assignment of the first certificate of deposit to the Bank did not specify that the funds were to be held only as security. The assignment simply recited that the certificate was "to be applied to the unpaid principal balance" of the note.

Although a security agreement was executed shortly after the time of the first $225,000 payment, none existed for the second payment in April 1981, some six months after the payment was made. I find and conclude that neither Wyatt nor the Bank viewed either of the two payments as anything other than principal-reducing payments. Their attempts to alter the nature of the payments in order to assist Wyatt in his disputes with Jouflas were ineffective.

Even if these payments were considered as collateral, rather than payments on the note, I conclude that the Bank's release of the certificates of deposit to Wyatt would mandate a reduction in the Note balance, for purposes of any foreclosure of the deed of trust. This reduction would be in the amount of the full value of the certificates. A senior lienholder, with actual knowledge of a junior lienholder's security rights in specific real property, has a duty not to release other available collateral, in which the junior creditor has no security interest, without a reciprocal reduction of its debt against the encumbered real property. This is a part of the senior creditor's more general obligation, where he has actual knowledge of a subordinate lien, not to engage in any conduct that needlessly impairs the junior creditor's security position. *Beckman v. Alberts*, 346 Ill. 74, 178 N.E. 367 (1931); *Pitman Building and Loan Association v. Wright*, 149 A. 820 (Ch. N.J. 1930); *King v. Milford National, Bank of Milford*, 168 Misc. 571, 6 N.Y.S. 2d 113 (1938). Where a senior creditor with such knowledge releases to the debtor the security in which the junior creditor has no right, rather than applying it against the senior debt, the senior creditor's mortgage is deemed

satisfied to the extent of the value of the relinquished security. *Pitman, supra.* See also *Continental Supply Co. v. Marshall*, 152 F.2d 300 (10th Cir. 1946), *cert. denied*, 327 U.S. 803; *Briggs v. Obermeyr [sic]*, 292 Ill. App. 79, 10 N.E. 2d 885 (1937); *Charles Construction Co., Inc. v. Leisure Resources, Inc.*, 307 N.E. 2d 336 (Mass. 1974); *Union National Bank v. Milburn and Stoddard Co.*, 7 N.D. 201, 73 N.W. 527 (1897).

Thus, in its release of the $450,000 to Wyatt when it had actual knowledge of Jouflas' secondary position, the Bank relinquished its right to proceed against the Jouflas Ranch for the full $900,000 Note balance. Phoenix, as a holder with knowledge of Wyatt's default, took the Note subject to all available defenses. § 4-3-306 Colo. Rev. Stat. Phoenix is therefore limited to foreclosing against the Jouflas Ranch for $928,553.42, less $450,000, plus 10% per annum interest on this balance, from and after November 13, 1981.

However, Jouflas is entitled to a judgment of this same amount against Wyatt. Whenever a party is compelled, though not personally bound, to pay a debt in order to protect his property from foreclosure, he is entitled to judgment against the original debtor in the amount of any funds so expended. *American Oil Co. v. McMillin* [sic], 508 P.2d 1345 (10th Cir. 1975); *Saunders v. Black*, 136 Colo. 47, 318 P.2d 1100 (1958); *Martynes & Associates, No. 1 Devonshire Square Apartments*, 680 P.2d 246 (Colo. App. 1984[)]; *Cagle v. Sammons*, 198 Neb. 595, 254 N.W. 2d 398 (1977).

Jouflas never assumed, nor was he in any way personally liable on, the Bank Note. Thus, to the extent

that he must pay Phoenix in order to protect his ranch, he is entitled to judgment against Wyatt. Jouflas is therefore entitled to judgment against Wyatt in the amount of $478,553.42, plus interest from November 13, 1981 at 10%. However, execution of this judgment is stayed until this court receives, and approves by a written order to be submitted by the plaintiff's counsel, proof of Jouflas' payment of an equal sum to Phoenix or to the Public trustee of Eagle County, Colorado (either before sale or through redemption).

Conclusion

Phoenix Petroleum is entitled to foreclose its deed of trust on the Jouflas Ranch, but only to the extent of $478,553.42, plus 10% interest from November 13, 1981. Judgment is ordered against Wyatt and in favor of Jouflas in the same amount, including all interest. However, Jouflas shall not execute on his judgment without further order of this court, which will be granted upon proof of Jouflas' payment to Phoenix or the Public Trustee of Eagle County, Colorado, of this sum.

The other relief sought by Phoenix is denied. As to Wyatt's claim that Jouflas breached an agreement to subordinate his mortgage to the bank's deed of trust, I find and conclude that Wyatt is not entitled to any relief.

Dated at Denver, Colorado. November 27, 1985.

BY THE COURT:

/s/

JIM R. CARRIGAN, JUDGE
UNITED STATES DISTRICT COURT

Entered November 29, 1985

APPENDIX C

ORDER AND JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT, No. 85-2928
(D.C. No. 83-C-177) (D. Colo.)

GEORGE P. JOUFLAS,
Plaintiff-Appellee,

v.

HUBERT N. PETERSON,
Public Trustee of Eagle County, Colorado,
Defendant,

PHOENIX PETROLEUM COMPANY,
Defendant-Appellant.

Before LOGAN, BARRETT, and SEYMOUR,
Circuit Judges.

Having reviewed the record and the briefs, and having heard oral argument, the court concludes that appellant has presented no argument on the law or the facts warranting reversal of the trial court's decision.

AFFIRMED.

Entered for the Court

Stephanie K. Seymour
Circuit Judge

Entered March 4, 1988

APPENDIX D

AMENDED ORDER AND JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT, Nos. 85-2912 and 85-2928
(D.C. No. 83-C-177) (D. Colo.)

GEORGE P. JOUFLAS,
Plaintiff-Appellee,

v.

HUBERT N. PETERSON,
Public Trustee of Eagle County, Colorado,
Defendant,

OSCAR S. WYATT, JR.
PHOENIX PETROLEUM COMPANY,
Defendant-Appellant.

The court, upon its own motion and in order to correct a clerical error, amends its order and judgment filed March 4, 1988, in case 85-2912 to show that the order and judgment applies to both cases 85-2912 and 85-2928.

It is further ordered that the time for filing a petition for rehearing in either case is extended to April 4, 1988.

/s/
ROBERT L. HOECKER, Clerk

Entered March 21, 1988